EDITOR'S NOTE

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No. 86-44

In the Supreme Court of the United States

OCTOBER TERM, 1986

Supreme Court, U.S.
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SHEARSON/AMERICAN EXPRESS, INC.
AND MARY ANN MCNULTY, PETITIONERS

v.

EUGENE MCMAHON, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether a federal district court is barred from enforcing agreements to arbitrate claims arising out of contractual relationships if those claims assert an implied right of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b).

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

This case raises two questions concerning the enforceability of predispute arbitration agreements between brokerage firms and their customers. The first question is whether a claim under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act or 1934 Act), 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, must be referred to arbitration in accordance with a predispute arbitration agreement. The second question is whether a claim under the RICO statute, 18 U.S.C. (& Supp. II) 1961 *et seq.*, must be referred to arbitration in accordance with such an agreement.

The Securities and Exchange Commission submits this brief to address the first of those questions. The Commission is the agency principally responsible for the administration and enforcement of the federal securities laws and regulations, including Section 10(b) and Rule 10b-5.

The Commission is responsible for overseeing and regulating the activities of stock exchanges and securities associations, including the rules they prescribe for arbitration of claims against their members, such as petitioner Shearson/American Express, Inc., in this case.

The Commission has two specific interests in the resolution of this case. First, the Commission urges the Court to limit its analysis to a narrower question than the broad question framed by the petition. The arbitration procedures specified in the agreement at issue here, between a broker-dealer and its customers, are subject to the Commission's broad oversight authority under Section 19 of the Exchange Act (15 U.S.C. 78s), which is sufficient to ensure that arbitration procedures are adequate to enforce statutory rights of customers against broker-dealers. The Commission believes that arbitration agreements specifying procedures subject to such oversight are enforceable and urges the Court to avoid addressing other circumstances, where, in contrast to this case, the Commission lacks oversight authority.

Second, the Commission urges the Court not to rely on a distinction between express and implied rights of action in resolving the question presented in this case. As we show below, that distinction should make no difference in determining the enforceability of an arbitration agreement. The implied right of action under Section 10(b) and Rule 10b-5 is as deserving of a hearing in a proper forum, and as necessary to effectuate the policies of the securities laws, as the various express rights of action. The Commission believes that it is important for the Court to avoid the contrary suggestion that might be thought implicit in a decision based on a distinction between express and implied rights of action.[1]

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[1] The Commission here addresses only the question whether the arbitration agreement is rendered unenforceable by virtue of the fact that the claim arose under the federal securities laws. We do not ad-

STATEMENT

Between 1980 and 1982, respondents Eugene and Julia McMahon, either individually or on behalf of various trusts, became customers of petitioner Shearson/American Express, Inc. (Shearson), a brokerage firm registered with the Securities and Exchange Commission (Pet. App. A9, A20). Their agreement with Shearson provided for arbitration of any controversy relating to the account pursuant to the rules of a securities industry self-regulatory organization (SRO) to which Shearson belonged (*ibid.*). The agreement provided (*id.* at A9):

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect.

In 1984, respondents filed a complaint in the United States District Court for the Southern District of New York against Shearson and Mary Ann McNulty, the registered representative who handled their accounts. The

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dress other grounds for challenging such agreements. We note, in this regard, this Court's recent reminder that "courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' " *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, No. 83-1569 (July 2, 1985), slip op. 12 (quoting 9 U.S.C. 2). See also *Wilko* v. *Swan*, 346 U.S. 427, 440 (1953) (Frankfurter, J., dissenting) (distinguishing situation where customer "had no choice but to accept the arbitration stipulation, thereby making the stipulation an unconscionable and unenforceable provision").

complaint alleged that petitioner McNulty, with the knowledge of Shearson, engaged in fraudulent, excessive, and inappropriate trading on their accounts and made false statements and omitted material facts in giving advice to respondents. The complaint alleged violations of, and sought relief under, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. 1962(c), and under state law rules governing fraud and breach of fiduciary duty (Pet. App. A9, A20-A21).

Petitioners, relying on the signed arbitration agreement, moved to compel arbitration of all of respondents' claims pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. 3. The district court granted the motion in part. The court first rejected respondents' argument that the arbitration provision was not enforceable because the customer agreement was a contract of adhesion (Pet. App. A22). The court then held that the state law claims were arbitrable under *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213 (1985), and that the RICO claims were not arbitrable because of the strong federal policies inherent in the enforcement of RICO (Pet. App. A23). Finally, the district court held that the claims under Section 10(b) and Rule 10b-5 were arbitrable (Pet. App. A25).

The court of appeals affirmed on the RICO and state-law claims (Pet. App. A15-A17) but reversed on the securities law claims (*id.* at A10-A15). With regard to the latter, the court observed that the Second Circuit had long denied compulsory arbitration to claims under Section 10(b) and Rule 10b-5 by extending to them the rule of *Wilko* v. *Swan*, 346 U.S. 427 (1953), that a claim under Section 12(2) of the Securities Act of 1933 (Securities Act or 1933 Act), 15 U.S.C. 77*l*(2), was not subject to compulsory arbitration (Pet. App. A10-A12).[2] The court

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[2] See *AFP Imaging Corp.* v. *Ross*, 780 F.2d 202, 205 (2d Cir. 1985), cert. denied, No. 85-1805 (June 30, 1986); *Allegaert* v. *Perot*, 548 F.2d 432, 437-448 (2d Cir.), cert. denied, 432 U.S. 910 (1977); *Greater Con-*

noted, however, that this Court and its members had on occasion cast doubt on the applicability of *Wilko* v. *Swan, supra*, to claims under the Exchange Act (Pet. App. A12-A14). See *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213, 215-216 & n. 1 (1985); *id.* at 224-225 (White, J., concurring); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 513-514 (1974). Nevertheless, the court of appeals deemed it improvident to depart from its own "settled law" and therefore held that the *Wilko* rationale was applicable to claims under the Exchange Act (Pet. App. A14-A15).[3]

SUMMARY OF ARGUMENT

The starting point for analysis of this case is the Federal Arbitration Act, 9 U.S.C. 1 *et seq.*, which provides for the enforcement of a contract to arbitrate as if it were any other contract. As this Court explained in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, No.

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tinental Corp. v. *Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970); *Colonial Realty Corp.* v. *Bache & Co.*, 358 F.2d 178, 183 n.5 (2d Cir.), cert. denied, 385 U.S. 817 (1966).

[3] Seven courts of appeals other than the Second Circuit have held that Section 10(b) claims are not subject to compulsory arbitration. See, *e.g.*, *Wolfe* v. *E.F. Hutton & Co.*, 800 F.2d 1032 (11th Cir. 1986) (en banc); *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986); *King* v. *Drexel Burnham Lambert, Inc.*, 796 F.2d 59 (5th Cir. 1986), petition for cert. pending, No. 86-282; *Conover* v. *Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986), petition for cert. pending, No. 86-321; *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, v. *Moore*, 590 F.2d 823, 827-829 (10th Cir. 1978); *Weissbuch* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-835 (7th Cir. 1977).

In *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1397-1398 (1986), petition for cert. pending, No. 86-578, the Eighth Circuit reached a contrary result, concluding that *Wilko* did not extend to Section 10(b) claims.

83-1569 (July 2, 1985), the command of the Federal Arbitration Act applies to arbitration of statutory claims as well as contract claims. A predispute arbitration agreement covering a statutory claim is unenforceable only if the statute giving rise to the claim reflects a congressional intent to limit or prohibit waiver of the right to bring the claim to court.

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), this Court held that a predispute arbitration agreement could not be enforced to compel arbitration of a claim arising under Section 12(2) of the Securities Act, 15 U.S.C. 77*l*(2). The basis for this ruling was that Section 14 of the Securities Act, 15 U.S.C. 77n, declares void any agreement to waive "compliance with any provision" of the 1933 Act. The Court concluded that arbitration was inadequate to protect the investor rights under Section 12(2).

In the present case, suit was brought against a broker-dealer under Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. The right of action under Section 10(b) and Rule 10b-5 is as important as the right of action under Section 12(2) of the 1933 Act, and Section 29(a) of the Exchange Act, 15 U.S.C. 78cc(a), like Section 14 of the 1933 Act, declares void any agreement to waive "compliance with any provision" of the 1934 Act. But under the circumstances of this case, respondents' agreement to submit to arbitration was not a waiver of petitioners' compliance with any provision of the 1934 Act, because arbitration is adequate to enforce petitioners' duties.

There are two related grounds of distinction between *Wilko* and the present case. First, since 1953 this Court has rejected the suspicion of arbitration on which *Wilko* was based. Second, since 1975 the Securities and Exchange Commission has had extensive authority to oversee and to regulate the arbitration procedures prescribed by stock exchanges and other self-regulatory organizations for use by

members (such as petitioner Shearson) in disputes with their customers. See Section 19 of the Exchange Act, 15 U.S.C. 78s. This regulatory authority, as its exercise to date demonstrates, can ensure that such arbitration procedures are adequate to protect statutory rights. Accordingly, there is no reason to treat a predispute agreement to arbitrate in accordance with such procedures as a prohibited waiver of compliance with any provision of the securities laws.

In holding the agreement in this case enforceable, the Court should limit its analysis to predispute arbitration agreements between brokerage firms and their customers that prescribe procedures that are subject to the Commission's oversight authority. The Commission takes no position on the enforceability of other predispute arbitration agreements. The Commission urges the Court that it is not necessary to decide here whether there are sufficient guarantees of the adequacy of arbitration in situations beyond the oversight power of the Commission.

The Commission further urges the Court not to rely, in deciding this case, on any supposed distinction between express rights of action, such as the one at issue in *Wilko* (under Section 12(2) of the Securities Act), and implied rights of action, such as the one at issue here (under Section 10(b) of the Exchange Act). Both kinds of rights are important, and no such distinction is relevant to determining whether arbitration is adequate to protect statutory rights and hence whether an agreement to arbitrate constitutes a waiver of compliance with any provision of the securities laws. Invocation of any such distinction, moreover, might be misconstrued to suggest a lesser importance or stature for implied rights of action, which would be contrary to this Court's decisions and destructive of investor protections under the securities laws.

ARGUMENT

THE ANTIWAIVER PROVISIONS OF THE FEDERAL SECURITIES LAWS DO NOT PRECLUDE ENFORCEMENT OF PREDISPUTE AGREEMENTS BETWEEN BROKERAGE FIRMS AND THEIR CUSTOMERS TO ARBITRATE DISPUTES UNDER ARBITRATION PROCEDURES PRESCRIBED BY SELF-REGULATORY ORGANIZATIONS SUBJECT TO THE REGULATORY AUTHORITY OF THE SECURITIES AND EXCHANGE COMMISSION

The Federal Arbitration Act, as construed by this Court, is the starting point for answering the question presented in this case. The Federal Arbitration Act creates "a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate * * *." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 25 n.32 (1983). The Act establishes a "federal policy favoring arbitration" (*id.* at 24). See also *Southland Corp.* v. *Keating*, 465 U.S. 1, 10 (1984). As this Court has recently noted, "there is no reason to depart from" the policy favoring arbitration "where a party bound by an arbitration agreement raises claims founded on statutory rights" (*Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, No. 83-1569 (July 2, 1985), slip op. 11). Thus, the Federal Arbitration Act, standing alone, would require the enforcement of an agreement to arbitrate statutory claims (*id.* at 12-13).

This statutory directive, like any other, may be overridden by a contrary legislative command. This Court has accordingly held that an agreement to arbitrate a statutory claim is not to be enforced if Congress has manifested an intent to protect against waiver of the right to a judicial forum for the particular claim (*Mitsubishi Motors Corp.*, slip op. 12-13). The opponent of arbitration, however, must overcome the presumption of enforceability of the agreement under the Federal Arbitration Act. "Having

made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue" (slip op. 13).

The question in this case is whether Congress has expressed an intent to preclude waiver of a customer's right to bring suit against a broker-dealer under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The asserted basis for finding such an intent is Section 29(a) of the Exchange Act, 15 U.S.C. 78cc(a), which declares void "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Act]." That provision, by its own terms, would bar enforcement of an arbitration agreement only if the agreement to accept a nonjudicial forum effected a waiver of the other party's duty to comply with the Exchange Act. Where, as in the present case, the Commission has sufficient statutory authority to ensure the adequacy of arbitration as a means of enforcing duties under the Exchange Act, there is no reason to conclude that an agreement to arbitrate constitutes such a waiver: under these circumstances, arbitration is adequate to vindicate Exchange Act rights, and therefore there can be no waiver of "compliance with any provision" of the Act.

A. *Wilko* v. *Swan* Held The Arbitration Agreement There In Issue Unenforceable Because The Court Deemed Arbitration, Under The Circumstances Of That Case, Inadequate To Enforce Compliance With Substantive Duties Under The Securities Laws

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), this Court considered whether the antiwaiver provision of Section 14 of the 1933 Act, 15 U.S.C. 77n, which is essentially identical to Section 29(a) of the Exchange Act,[4] precluded the en-

[4] Section 14 provides:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of

forcement of a predispute arbitration agreement. The plaintiff brought an action for damages under Section 12(2) of the Securities Act, 15 U.S.C. 77*l*(2). The defendant, relying on a predispute arbitration agreement, moved to stay the action and compel arbitration pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. 3. This Court held that enforcement of the arbitration agreement would be contrary to Section 14 of the 1933 Act.

The Court said that Section 22(a) of the 1933 Act, 15 U.S.C. 77v(a), which permits suit to be brought in federal or state court, "is the kind of 'provision' that cannot be waived under § 14 of the Securities Act" (346 U.S. at 435). This "semantic reasoning" (*Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513), however, was only the beginning of the Court's analysis. Most of the Court's opinion concerns the perceived inadequacy of arbitration as a substitute for adjudication (346 U.S. at 435-438). Although the *Wilko* opinion is, we acknowledge, not entirely clear on this point, we think the case must be read as holding that a waiver of the "right to select the judicial forum" (*id.* at 435) is unenforceable only because arbitration was judged inadequate to enforce the statutory duties created by Section 12(2).

The statutory language itself strongly suggests this reading of *Wilko*. What is prohibited by Section 14 is enforcement of waivers of "compliance with any provision" of the 1933 Act or regulations. But Section 22(a) does not itself impose on sellers of securities, like the defendant in *Wilko*, any duty with which they must "comply." *Wilko*

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this subchapter or of the rules and regulations of the Commission shall be void.

This Court has viewed Section 14 of the 1933 Act and Section 29 of the 1934 Act as identical for all relevant purposes. See *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 514 n.7 (1974). See also *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 224-225 (White, J., concurring).

makes sense under the language of Section 14 only to the extent it was based on the judgment that a judicial forum was needed to protect the substantive rights at issue—that is, the rights under Section 12(2).[5]

In fact, the opinion in *Wilko* is principally concerned with explaining why arbitration is not an adequate substitute for adjudication as a means of enforcing "the provisions of the Securities Act, advantageous to the buyer" (346 U.S. at 435). The Court introduces this explanation by saying that the "effectiveness [of the Act's provisions] in application is lessened in arbitration as compared to judicial proceedings" (*ibid.*). The Court concludes the discussion by expressly giving the inadequacy of arbitration as the reason for its conclusion: "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 * * * to apply to waiver of judicial trial and review" (*id.* at 437 (footnote omitted)). The *Wilko* opinion itself thus expressly bases its decision on the conclusion that arbitration is inadequate to enforce substantive rights.

There was no evidence cited in *Wilko* that Congress actually considered the subject of arbitration when enacting the securities laws. Accordingly, the task of the *Wilko* Court was to determine the precise extent to which the Securities Act required a limitation on the otherwise applicable Federal Arbitration Act. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 127 (1973). The Court said, "[t]wo policies, not easily reconcilable, are involved in this case" (*Wilko*, 346 U.S. at 438). The Court's reconciliation of those policies turned on its perception, at the time of decision, of the defects of arbitration as a means of enforcing statutory rights.[6]

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[5] This brief does not address the question whether, in particular circumstances, there are procedural rights that cannot be waived.

[6] Justices Frankfurter and Minton, dissenting in *Wilko*, plainly read the opinion as finding a violation of Section 14 only because the

Accordingly, under the plain language of Section 29(a) of the Exchange Act, construed in conformity with *Wilko*'s construction of Section 14 of the Securities Act, an agreement to arbitrate a claim under the Exchange Act or its implementing regulations is enforceable by the defendant unless arbitration is inadequate to protect substantive statutory rights, so that an agreement to arbitrate is tantamount to a waiver of those rights. The *Wilko* Court found arbitration inadequate in 1953 and therefore held the arbitration agreement before it unenforceable. The Court based its holding not on a view of the particular arbitration in that case, which had not yet taken place, but on its view of arbitration and its protections generally. As we next show, that view is no longer warranted in cases like the present, where the arbitration procedures have subsequently come under the oversight of the Commission. Since mechanisms now exist to ensure that arbitration provides an effective means by which investors like respondents can pursue claims against their brokers under the securities laws, an agreement to arbitrate such claims is not a waiver of compliance with the provisions of those laws and is therefore enforceable under the Federal Arbitration Act.

Court believed that arbitration could not effectively enforce the substantive "protective provisions" of the securities laws. The dissent disagreed with the majority only in its assessment of the adequacy of arbitration (346 U.S. at 439-440). The dissent concluded that the arbitration agreement should be enforceable because there was "nothing in the record * * * to indicate that the arbitral system * * * would not afford the plaintiff the rights to which he is entitled" (346 U.S. at 439 (footnote omitted)). The dissent cautioned, however, that, "[i]f arbitration inherently precluded full protection of the rights § 12(2) of the Securities Act affords to a purchaser of securities, or if there were no effective means of ensuring judicial review of the legal basis of the arbitration, then, of course, an agreement to settle the controversy by arbitration would be barred by § 14 * * *" (*ibid.*).

B. Arbitration Subject To The Commission's Post-1975 Regulatory Authority Is Adequate To Enforce Substantive Duties Under The Securities Laws

The view of arbitration on which *Wilko* rested is today inappropriate in cases involving disputes between registered broker-dealers and their customers. Under Section 19 of the Exchange Act, 15 U.S.C. 78s, the Commission has broad regulatory authority over securities exchanges and other self-regulatory organizations (SROs). Since 1975, when Congress amended Section 19 to expand that authority, the Commission has had the power to ensure that arbitration procedures prescribed by the SROs are adequate to enforce the rights of customers against brokerage firms that are members of SROs. In these circumstances, the suspicion of arbitration on which *Wilko* rested is inappropriate, and an agreement to arbitrate accordingly should not be deemed a waiver of rights under the Exchange Act.

1. The result in *Wilko* did not depend on any evidence of actual congressional consideration of the adequacy of arbitration to enforce rights arising under the securities laws. It was determined instead by this Court's mistrust of arbitration. The Court, however, has come to another assessment of arbitration since *Wilko* was decided in 1953. As the Court recently stated, "we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution." *Mitsubishi Motors Corp.*, slip op. 12. See also *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 220 & n. 6; *Southland Corp.* v. *Keating*, 465 U.S. 1, 13-17 (1984); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 510-511 & n. 4. Indeed, this Court has emphasized that there is a strong federal policy favoring arbitration as an alternative method of dispute resolution—a method that does not re-

quire sacrifice of substantive rights and is typically faster and cheaper than traditional litigation. *Mitsubishi Motors Corp.*, slip op. 13.

2. There has also been a change in the particular statutory context in which this case arises. In 1975, the Commission's oversight power was enlarged, giving it the power to ensure the adequacy of arbitration procedures employed in a case like the present one. This change enables the Court to decide this case without broader consideration of the principles affecting the arbitrability of statutory claims generally.

The regulatory scheme established by the Exchange Act has long relied in large part on the efforts of the SROs—the national securities exchanges and registered securities associations—subject to Commission oversight. See generally S. Rep. 94-75, 94th Cong., 1st Sess. 22-23 (1975). Any registered broker-dealer effecting transactions in securities must be a member of an SRO. Section 15(b)(8), 15 U.S.C. (Supp. II) 78*o*(b)(8). SROs are required to register with the Commission, to promulgate rules governing the conduct of their members, and to enforce compliance by their members with those rules and with the federal securities laws. See, *e.g.*, Section 6 of the Exchange Act, 15 U.S.C. 78f (regarding securities exchanges); Section 15A of the Exchange Act, 15 U.S.C. 78*o*-3 (regarding securities associations). In order to ensure compliance with these statutory requirements, the Commission has long had authority to oversee and to regulate SRO activities. See generally Section 19 of the Exchange Act, 15 U.S.C. 78s.

The Commission's authority over arbitration procedures is part of its broad Section 19 power over SRO rules. In 1953, however, when this Court decided *Wilko*, the Commission's authority over SRO rules was much more circumscribed than it is today. With respect to

securities associations, which were not at issue in *Wilko,*[7] the Commission's authority, though broad, was weaker than it is now. The Commission's authority over the rules of exchanges was much more limited and appears not to have included any authority over their arbitration rules at all.[8] It was not until the 1975 amendments to the 1933 and 1934 Acts—the " 'most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act of 1934' "[9]—that Congress granted the Commission its present expansive authority

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[7] The arbitration agreement at issue in *Wilko* specified that any arbitration proceedings would be governed by the customer's choice from among certain specified sets of arbitration rules, not including the rules prescribed by any securities association. 346 U.S. at 432 n.15.

[8] The then-existing Section 19(b) gave the Commission authority to "alter or supplement" exchange rules only with respect to specifically enumerated areas (which did not include arbitration procedures) or "similar matters." 48 Stat. 898 (amended 1975). The Commission's authority over the rules of securities associations, while broader, was likewise limited in important respects. Then-existing Section 15A, 52 Stat. 1070 (amended 1975), authorized the Commission to disapprove "any change in or addition to" a securities association's rules (Section 15A(j), 15 U.S.C. (1964 ed.) 78*o*-3(j) (amended 1975)), and to "abrogate any rule" of an association if the Commission found abrogation necessary or appropriate to effectuate the purposes of the Act (Section 15A(k)(1), 15 U.S.C. (1964 ed.) 78*o*-3(k)(1) (amended 1975)). The Commission's authority to "alter or supplement" association rules, however, extended only to certain enumerated matters, none of which included arbitration procedures. Section 15A(k)(2), 15 U.S.C. (1964 ed.) 78*o*-3(k)(2) (amended 1975).

[9] *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 384-385 (1983) (quoting *Securities Acts Amendments of 1975: Hearings on S. 249 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs;* 94th Cong., 1st Sess. 1 (1975)).

over exchange rules.[10] The 1975 amendments were designed to enhance greatly the Commission's authority over SRO rules and procedures. See S. Rep. 94-75, 94th Cong., 1st Sess. 22-23, 29-32 (1975).

Under current law, each SRO must file with the Commission any proposed change to its rules (Section 19(b)(1), 15 U.S.C. 78s(b)(1)), including the rules and procedures governing the conduct of arbitration programs administered by the SRO. Upon the filing of any proposed rule change, the Commission must publish notice of the change and provide interested parties an opportunity to comment (*ibid.*). Subject to certain exceptions, no proposed rule change may take effect unless approved by the Commission (*ibid.*). The Commission must grant such approval if it finds that the proposed rule is consistent with the requirements of the 1934 Act and with the rules and regulations thereunder applicable to SROs. Section 19(b)(2), 15 U.S.C. 78s(b)(2). Moreover, the Commission may, on its own initiative, "abrogate, add to, and delete from" any SRO rule if it finds such changes necessary or appropriate to further the purposes of the Act. Section 19(c), 15 U.S.C. 78s(c). In short, the Commission has sweeping authority over the rules adopted by SROs relating to arbitration of customer disputes, including the power to mandate the adoption of any additional rules it deems necessary to ensure the adequacy of an SRO's arbitration system.

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[10] Pub. L. No. 94-29, § 16, 89 Stat. 146. Pursuant to the 1975 amendments, the Commission now has authority over *all* SRO rules, including those of the exchanges; the Commission's authority is not limited to enumerated categories. See Section 19(b) and (c), 15 U.S.C. 78s(b) and (c). See also S. Rep. 94-75, 94th Cong., 1st Sess. 31 (1975) ("[t]he bill would give the SEC clear authority to amend any self-regulatory organization's rules in any respect consistent with the objectives of the Exchange Act").

The Commission has exercised this new authority since 1975 in several ways specifically designed to promote fair and effective arbitral forums for the resolution of disputes between customers and SRO-member brokerage firms. Chief among them was the Commission's promotion, in 1977, of the formation of the Securities Industry Conference on Arbitration, a group consisting of representatives of various SROs, the Securities Industry Association, and the public, and created to develop a uniform arbitration code.[11] The Conference drafted the Uniform Code of Arbitration, and the Code has since been adopted by all of its SRO members.[12]

Pursuant to Section 19(b), 15 U.S.C. 78s(b), and Rule 19b-4 thereunder, 17 C.F.R. 240.19b-4, the Commission has approved the Code as part of the rules of the various SROs. See, *e.g.*, Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979). In so doing, the Commission noted that the Uniform Arbitration Code "marks a substantial improvement over the various arbitration procedures currently being utilized by the securities industry and represents an important step toward establishing a uniform system for resolving investor complaints through arbitration" (*id.* at 1199 (foot-

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[11] See Securities Exchange Act Release No. 13470, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,136 (Apr. 26, 1977); Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 283-284 (1984).

[12] See, *e.g.*, New York Stock Exchange, Inc. Const., art. XI, 2 N.Y.S.E. Guide (CCH) ¶¶ 1501-1503 (1984); Rules 600-634 of the N.Y.S.E. (*id.* ¶¶ 2600-2634); Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Man. (CCH) ¶¶ 3701-3743 (1986); Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J (1984). See also Appendix A to Securities Industry Association, Inc. Amicus Curiae Brief (reprinting Uniform Code of Arbitration).

note omitted)). The arbitration procedures of the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers, mentioned in the arbitration agreement at issue in this case, were specifically approved by the Commission (*ibid.*).[13]

3. Although the question presented in this case is similar to that presented in *Wilko*, the circumstances in 1986 compel a different answer. Today there still is no specific expression of congressional intent on the arbitrability of securities-law claims.[14] Rather, the Court

[13] Besides promoting and approving the Uniform Code, the Commission has also taken other actions concerning arbitration designed to protect investors. In 1979 the Commission issued a release announcing that, prior to signing a standard customer agreement containing an arbitration clause, customers should be advised by the broker that, under the existing case law, they are not foreclosed from seeking a judicial remedy. Securities Exchange Act Release No. 15984, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,122 at 81,978 (July 2, 1979). (The courts below did not have occasion to consider any possible bearing of this release on the intentions of the parties to the contract at issue in this case.) In 1983, the Commission promulgated Rule 15c2-2, 17 C.F.R. 240.15c2-2, which codified its view under the existing case law that the insertion of language in broker-customer agreements purporting to bind customers to arbitration of all future disputes is "a misleading statement of customers' rights under the federal securities laws." Securities Exchange Act Release No. 20397, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,452, at 86,357 (Nov. 18, 1983). These actions were premised on the Commission's assumption, based on court of appeals decisions following *Wilko*, see note 3, *supra*, that agreements to arbitrate Rule 10b-5 claims were not, in fact, enforceable.

In 1975, the Commission filed an amicus brief in *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), cert. denied, 429 U.S. 1010 (1976), urging extension of *Wilko* to a Section 10(b) claim. As the present brief indicates, the Commission has reconsidered its position and no longer holds the view urged in the 1975 brief.

[14] Contrary to the suggestion of several courts of appeals (*Wolfe* v. *E.F. Hutton & Co.*, 800 F.2d at 1032; *Conover* v. *Dean Witter Reynolds, Inc.*, 794 F.2d at 524; *Weissbuch* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d at 836; *Ayres* v. *Merrill Lynch, Pierce,*

must once again determine whether arbitration adequately protects statutory rights. Today, agreements to arbitrate in accordance with SRO rules adopted pursuant to the Exchange Act and approved by the Commission should not be viewed as waiving the protections of the Exchange Act.

The courts, as well as the Commission, can take steps to ensure that the rights afforded by the federal securities laws are enforced in arbitration proceedings. This Court noted in *Mitsubishi Motors Corp.*, slip op. 12, that fraud and overreaching remain grounds for revoking an arbitration agreement. The *Mitsubishi* Court further observed that arbitrators are bound to apply the law and expressly reserved consideration of "the effect of an arbitral tribunal's failure to take cognizance of the statutory cause of action on the claimant's capacity to reinitiate suit

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Fenner & Smith, Inc., 538 F.2d at 537), the only evidence in the 1975 amendments or their legislative history of congressional intent regarding arbitrability of securities-law claims shows that Congress left the issue to the courts.

The Conference Report states that, in amending Section 28 of the Exchange Act, 15 U.S.C. 78bb, to permit compulsory arbitration between brokers and exchanges, Congress "did not change existing law, as articulated in *Wilko* v. *Swan* * * *, concerning the effect of arbitration proceeding provisions in agreements [between brokers and customers]." H.R. Rep. 94-229, 94th Cong., 1st Sess. 111 (1975). And an amendment to Section 15B(b)(2)(D) of the Exchange Act, 15 U.S.C. 78*o*-4(b)(2)(D), permits arbitration among municipal securities dealers but provides that a customer cannot be compelled to arbitrate disputes "except at his instance and in accordance with section 78cc of this title." The statement in the Conference Report merely disclaims any intent to alter *Wilko*. The Section 15B amendment merely forbids arbitration without any agreement by the customer or otherwise than in accordance with Section 29. Neither the amendment nor the Conference Report indicates an intent to preclude further consideration of the *Wilko* issue by the courts. See *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d at 1398 n. 17. Of course, this Court in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-514, had, only one year prior to the 1975 amendments, cast doubt on the applicability of *Wilko* to Exchange Act claims.

in federal court" (slip op. 22 n.19). The point made by Justice Frankfurter in dissent in *Wilko* (346 U.S. at 440, quoting *Wilko* v. *Swan*, 201 F.2d 439, 445 (2d Cir. 1953)) is of course applicable to securities-law plaintiffs:

> Arbitrators may not disregard the law. Specifically they are * * * "bound to decide in accordance with the provisions of section 12(2)." On this we are all agreed. * * * [F]ailure to observe this law "would * * * constitute grounds for vacating the award * * *."

Accordingly, in light of the Commission's oversight authority under Section 19 of the Exchange Act, the customer-broker arbitration agreement in this case does not effect a waiver of the protections of the Act and should therefore be enforced. The same conclusion would apply to agreements to arbitrate any federal securities-law claim where the arbitration procedures are subject to the Commission's Section 19 authority. Thus, a present-day customer-broker agreement to arbitrate pursuant to SRO arbitration procedures would be enforceable, even with respect to claims arising under Section 12(2) of the 1933 Act, the section under which the claim in *Wilko* arose, as long as SRO arbitration procedures are specified.

Not all arbitration agreements covering claims arising under provisions of the securities laws would necessarily involve arbitration procedures subject to the Commission's Section 19 oversight authority. Agreements, for example, between investment advisors and their clients, and certain agreements that might purport to require arbitration of claims arising under the proxy rules, or in tender-offer or public offering contexts, might not specify SRO abitration procedures. No such agreement is before the Court. The argument made in this brief would not apply to such an agreement, and a separate analysis would be necessary to determine whether the arbitration procedures

are adequate to protect statutory rights. We urge the Court to limit its decision in this case to agreements specifying procedures subject to the Commission's oversight authority.

C. The Distinction Between Express and Implied Rights Of Action, And Technical Distinctions Between The 1933 and 1934 Acts, Are Irrelevant To The Decision In This Case

A major purpose of this brief is to urge the Court not to let the unsatisfactorily explained decision in *Wilko* lead it to distinguish that case today on grounds that would in our judgment be productive of mischief. In *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 224-225, Justice White, wrestling with *Wilko* in a concurring opinion, suggested that the holding of *Wilko* might be inapplicable to Section 10(b) claims for reasons different from those urged by the Commission above. The Court in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-514, had noted similar potential grounds for not extending *Wilko* to Section 10(b) claims. Although neither Justice White's *Byrd* concurrence nor the Court's opinion in *Scherk* goes beyond pointing out potential grounds of distinction and indicating the impossibility of automatically and "mechanically transplant[ing]" the *Wilko* decision to the 1934 Act (470 U.S. at 224), the Commission believes that it is important for the Court to avoid deciding this case on the basis of any supposed distinction between the two Acts or between express and implied causes of action. In particular, in the Commission's view, reliance on any distinction between express and implied causes of action has no place in the analysis, would be inconsistent with prior decisions of this Court, and might impair the protections of the securities laws.

Justice White noted in his *Byrd* concurrence that *Wilko* relied on three "interconnected statutory provisions" of the 1933 Act: the antiwaiver provision of Section 14; Sec-

tion 12(2), which creates a "special right" different from a common-law action for misrepresentation; and Section 22, which allows suit in any state or federal court of competent jurisdiction. 470 U.S. at 224. He stated that, while Section 29 of the 1934 Act is analogous to Section 14 of the 1933 Act, "counterparts of the other two provisions are imperfect or absent altogether" (470 U.S. at 224).[15] In particular, he noted that the Section 10(b) cause of action is implied rather than express. The phrase " 'waive compliance with any *provision of this chapter*' " in Section 29 is, he said, "literally inapplicable." *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 225 (White, J., concurring) (citation omitted; emphasis added). He added, "*Wilko*'s solicitude for the federal cause of action—the 'special right' established by Congress * * *—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common-law action" (*ibid.*; see *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-514).[16]

These potential distinctions should play no role in the analysis of this case. To begin with, the difference in the jurisdictional provisions is of no significance either to the interpretation of the two statutory antiwaiver provisions or in relation to the policy of preserving the protections of the Acts.[17] Nor is there significance to any differences in

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[15] In fact, the jurisdictional section of the 1933 Act, Section 22, 15 U.S.C. 77v, has a counterpart in Section 27 of the 1934 Act, 15 U.S.C. 78aa. The latter allows suit only in federal court.

[16] Subsequent to *Byrd*, a number of district courts, including the district court in this case, and the Eighth Circuit in *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, have adopted some of these distinctions in concluding that *Wilko* should not be extended to Section 10(b) claims. See Pet. App. A32-A38, citing cases.

[17] The distinction between the jurisdictional provisions of the 1933 and 1934 Acts is irrelevant to the issue in this case. The issue is whether a "judicial forum" (*Wilko*, 346 U.S. at 435) must be available for the vindication of rights under the 1933 Act—not whether a

the procedural protections surrounding Section 10(b) of the 1934 Act and Section 12(2) of the 1933 Act[18] or to differences in how closely they compare to common-law causes of action.[19] There is simply no reason to believe,

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claimant has a choice of state or federal courts. Some authorities have attributed the difference between Section 22 and Section 27 to "pure happenstance." Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 Duke L.J. 548, 567 (citing ALI, *Study of the Division of Jurisdiction Between State and Federal Courts* 183 (1969)). See also Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 Yale L.J. 95, 109 n.58 (1979).

[18] In some respects private plaintiffs in Section 10(b) actions are afforded greater procedural protections than are plaintiffs who assert the express remedy provided by Section 12(2). For example, under the Securities Act there is a statute of limitations of one year from the time the violation was or should have been discovered, with an absolute limit of three years from the offer or sale of the security (Section 13, 15 U.S.C. 77m), whereas in a Section 10(b) action the law of the forum state provides the applicable statute of limitations, which is usually longer. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 210 n.29 (1976). In addition, Section 11(e) of the Securities Act, 15 U.S.C. 77k(e), authorizes a court to require a Section 12(2) plaintiff to post a bond for costs, including attorneys' fees, and in certain circumstances assess costs against the plaintiff; no comparable provisions apply to plaintiffs in Section 10(b) actions. 425 U.S. at 209-210. Finally, the Exchange Act provides a wider choice of venue within the federal court system than does the Securities Act. Compare Section 27 of the Exchange Act, 15 U.S.C. 78aa, with Section 22(a) of the Securities Act, 15 U.S.C. 77v(a).

[19] In *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 388-389 (1983), this Court recognized a significant difference between common-law fraud actions and Section 10(b) actions—the plaintiff's burden of proof. A plaintiff under Section 10(b) must prove a violation by the "preponderance of the evidence," notwithstanding the traditional use of a "clear and convincing evidence" standard in common-law fraud actions. As the Court stated (459 U.S. at 388-389 (footnote omitted)):

> [T]he antifraud provisions of the securities laws are not coextensive with common-law doctrines of fraud. Indeed, an important

based on the statutory language or policies, that any of these differences reflects any congressional intent that a Section 12(2) claim, but not a Section 10(b) claim, shall be nonarbitrable.

Most critical, Section 10(b) is just as much a "provision" of the 1934 Act, with which persons trading in securities are required to "comply," as Section 12(2) is of the 1933 Act. The question presented by the language of the anti-waiver provisions, Sections 14 and 29, and first analyzed in *Wilko*, is whether acceptance of arbitration is, because of the supposed inadequacy of that remedy, tantamount to a waiver of "compliance" with any substantive "provision" of the Act in question. The answer to that question does not depend in any way on whether the *plaintiff*'s right to sue under a particular provision is expressly stated or implied. The adequacy of arbitration to ensure the *defendant*'s "compliance" with the provisions of the Act is wholly independent of whether Congress made a right of action express or the courts inferred it. That distinction simply has no place in a proper analysis of the issue here.

Reliance on the distinction, moreover, would be inconsistent with this Court's explanations of the nature of the implied right or action under Section 10(b). In *Herman & MacLean* v. *Huddleston*, 459 U.S. at 380 (footnote omitted), the Court stated that a private right of action under Section 10(b) and Rule 10b-5 "has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure." That Congress decided to leave Section 10(b) intact when it extensively revised the Exchange Act in 1975 reconfirms the existence of the private right of action. 459 U.S. at

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purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry.

384-386; cf. *Merrili Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 381-382 (1982) ("that a comprehensive reexamination and significant amendment of the [Commodity Exchange Act] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy") (footnote omitted); *Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it reenacts a statute without change * * *"). More generally, "[t]o say that a private cause of action is implied is to say that Congress intended such an action to exist." *Wolfe* v. *E.F. Hutton & Co.*, 800 F.2d at 1039 (Tjoflat, J., concurring). See *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 575 (1979) ("[t]he central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action"). Thus, with regard to congressional intent in general, and the intent to preserve investor protections in particular, express and implied rights of action stand on an equal footing.

Further, this Court has specifically recognized in two recent decisions that the Section 10(b) implied right of action is of no less stature, and is no less entitled to full respect and enforcement, than express rights provided by the securities laws. In *Huddleston,* the Court rejected the argument that an overlap should not exist between express and implied rights and held that the express remedy provided by Section 11 of the 1933 Act, 15 U.S.C. 77k, does not displace the implied remedy under Section 10(b) and Rule 10b-5. In *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, No. 84-679 (June 21, 1985), the Court rejected the argument that the in pari delicto defense be given a broader application in private Section 10(b) actions because that cause of action is implied rather than express. The Court said, "implied private actions provide 'a most

effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.' " *Bateman Eichler*, slip op. 10 (quoting *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964)). See also *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975). After *Huddleston* and *Berner*, any suggestion of greater congressional solicitude for express rights of action than for the implied right of action under Rule 10b-5 would be insupportable.

Given the historic recognition of the importance of implied causes of action, the Commission urges the Court not to premise its decision in this case on a distinction between express and implied remedies. That distinction is irrelevant to the proper analysis of the case and is incompatible with the importance of the Section 10(b) remedy in the arsenal of securities law protections. There is, in addition, an important practical consideration. Any reliance on such a distinction might be interpreted as suggesting that the Section 10(b) implied right of action is somehow inferior to express rights. The Commission urges the Court to avoid any suggestion that might thus interfere with the effective enforcement of the securities laws.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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